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COMMENTS

INCREASING THE FLOW OF PRIVATE FUNDS TO THE UNDERDEVELOPED COUNTRIES: A PROPOSAL

If the underdeveloped nations of the world are to achieve their goal of a substantial increase in their standards of living, they must import private capital. Foreign investors, however, have recently shown a reluctance to invest abroad because of the increasing risk of uncompensated expropriation of their property. Several current proposals seek to reduce this risk by limiting the power of states to acquire alien property. This approach appears to be ineffective because of the reluctance of the underdeveloped nations to agree to abide by foreign standards of property treatment.

After outlining the nature of the problem and analyzing the strengths and weaknesses of various plans and programs, this Note suggests a fundamentally new approach to the difficulties posed by expropriation. The basic thesis is that the flow of private capital can be increased by granting the underdeveloped nations wide latitude in acquiring foreign-owned property in exchange for an agreement to compensate the investor whose property has been expropriated. This scheme will grant the host nations their desired freedom from interference while developing their legal and economic systems. At the same time, it will provide the investor with a higher degree of probability of receiving adequate compensation following expropriation. This Note develops this thesis and concludes with a model treaty which incorporates specific desirable features.

I. THE ECONOMIC SETTING

The current *minimum* capital needs of the underdeveloped nations is estimated to be \$19 billion per year.¹ This \$19 billion is capable of increasing the annual per capita growth rate of these countries from one per cent to only two per cent. At the same time, the developed

¹ *Financing of Economic Development*, U.N. Doc. Nos. E/4079/ Rev. 1 (1965); A/5195/Rev. 1 (1961). These reports furnish the statistical source for nearly all writing in the field. See e.g., ALPERT, *ECONOMIC DEVELOPMENT* 246 (1963); BENHAM, *ECONOMIC AID TO UNDERDEVELOPED COUNTRIES* 65 (1962). Since the statistical base had been changed between the two reports, the figures reported herein may be interpolative. Subsequent data is drawn from these sources unless otherwise indicated.

nations are experiencing growth rates from three to five per cent. In contrast to their needs, the total net capital received by the capital importing, or host, nations from foreign sources has remained fairly constant. The flow averaged a little over \$5.4 billion per year during the 1950's, increased steadily to \$8 billion per year in 1961 and then declined to \$7.3 billion in 1963. The exact figures for 1964 are not yet available, but latest estimates place the total investment flow for that year at \$7.9 billion, a significant increase over the previous year. The economic gap between the underdeveloped and the developed is, curiously, widening and not narrowing.²

An examination of the known sources of capital that are available to developing countries illustrates the structure of the existing problem. These sources break down into two general categories: domestic and foreign, or internal and external. For present purposes, an examination of the further divisions of domestic sources of capital is unnecessary, for even in their total sum, they are generally inadequate to nurture growth in the not-fully-industrialized countries.³ It is probably true that far more domestic capital is available in the underdeveloped countries than has been utilized in the past because of the exorbitant interest rates facing prospective borrowers, inadequate banking systems, the absence of fluid money markets, and the desire of firms, both foreign and domestic, to export their earnings to the United States, Switzerland or other financial havens. However, even if all available domestic capital were to be utilized as efficiently as possible, it would still, in the great majority of cases, prove inadequate.⁴ The need for external sources remains unquestionable.

Before examining the subdivisions of external sources of capital, it is helpful to consider the overall financial situation in the underdeveloped, or capital-importing countries. In 1964 (a year of reversal in the downward trend of capital imports) these countries were in their best economic position in a decade. As a group, they were in fiscal balance, *i.e.*, their inflow of capital equalled their current account

² Cf. Maizels, *The Effects of Industrialization on Exports of Primary-Producing Countries*, 14 KYKLOS 18 (1961). Maizels' analysis is criticized by Bieda, *The Causes of the Export Lag of The Industrializing Countries*, 15 KYKLOS 485 (1962). Maizel replies, 15 KYKLOS 485, 493 (1962).

³ HIGGINS, *ECONOMIC DEVELOPMENT* 569 (1959). For a critical analysis of the point, see CAIRNCROSS, *FACTORS IN ECONOMIC DEVELOPMENT* 39-74 (1962).

⁴ ALPERT, *op. cit. supra* note 1, at 231. This inadequacy has been a common historical phenomenon as is shown by the United States' demand for British capital that lasted well into the nineteenth century and the continuing need of a country as highly industrialized as Canada for United States capital to develop her resources.

deficit plus marginal replacement of reserves.⁵ Unfortunately, optimism fades when prices enter the picture.⁶ The improvement in terms of trade begun in 1950 came to a sudden halt as import expenditures caught up with export receipts.⁷ One reason for this is the high cost of carrying fixed obligations. The ratio of debt service payments to exports of the developing countries rose from four per cent in 1956 to over eleven per cent in 1963. The rapid increase in the percentage (and absolute) amount of interest payments has seriously affected the liquidity of these nations. As it becomes increasingly difficult for them to finance short-term operations and transactions, costs rise and profits fall. And as export incomes fall, the effect of the fixed charge of debt servicing is greatly magnified throughout the economy. Thus, if additional external funds are not available, reserves again may have to be drawn down, a procedure which becomes increasingly difficult.

A further look into the external sources of capital is necessary. These fall into three main groupings: unilateral official assistance (foreign aid and long-term government loans), multilateral agency loans (International Bank for Reconstruction and Development (I.B.R.D.) and other development bank loans), and long-term private capital. Historically, private funds have constituted a major source of capital for underdeveloped nations.⁸ The total quantity of private capital transferred to these nations, however, has declined steadily from an average of \$2.2 billion per year for 1950-1960 to \$1.6 billion in 1963 (see chart 1, on following page). A sharp upturn appears to have occurred in 1964, with that figure reaching \$2.0 billion, which is still below the average for 1950-1960. During the same period, the amount of unilateral official assistance and multilateral agency loans to these nations increased significantly. Thus, it can be seen that not only has the absolute amount of direct private investment in the underdeveloped countries generally decreased during the last decade, but until quite recently, such funds have occupied a steadily decreasing percentage of the total foreign capital received by these countries (see chart 2

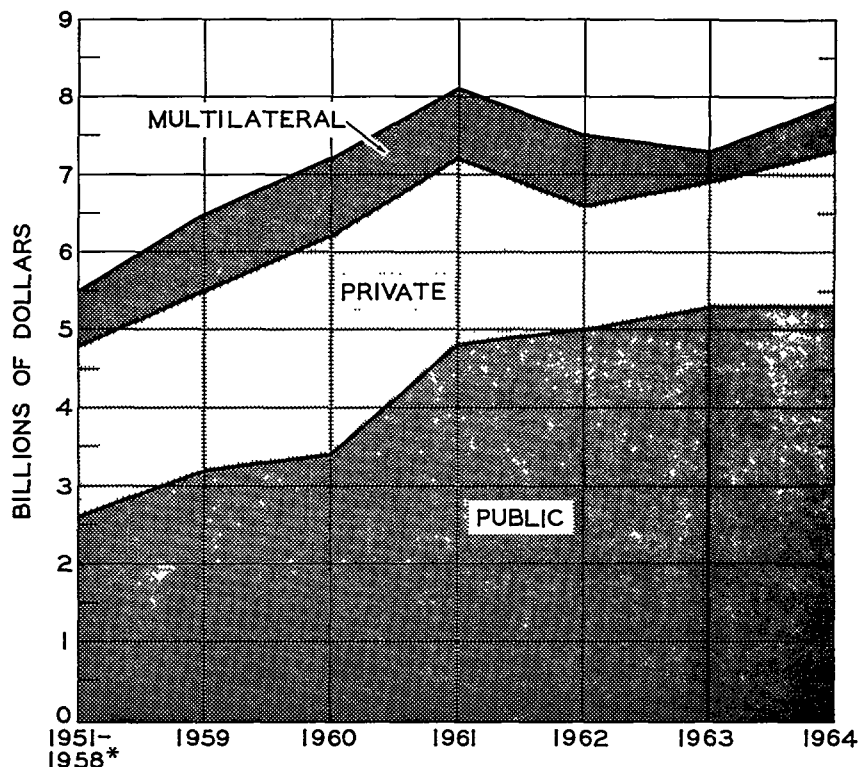
⁵ *Financing of Economic Development*, U.N. Doc. No. E/4079 (1964), at 6.

⁶ For an analysis of the effect of prices in the trade of manufactured goods for primary products, see BENHAM, *op. cit. supra* note 1, at 43; SINGER, *INTERNATIONAL DEVELOPMENT: GROWTH AND CHANGE* 165 (1964).

⁷ This phenomenon is caused by a decrease in the price of primary products which are exported by the underdeveloped nations relative to the cost of their manufactured imports. *World Economic Survey 1963, vol. 1, Trade and Development: Trends, Needs and Policies*, U.N. Doc. No. E/3908 (1964), at 5.

⁸ ALPERT, *op. cit. supra* note 1, at 231. Japan is a noteworthy exception, having received her foreign capital mainly in the form of government loans.

NET FLOW OF LONG-TERM CAPITAL FROM DEVELOPED TO UNDERDEVELOPED COUNTRIES 1951-1964



* VALUES SHOWN ON THIS COORDINATE REPRESENT CAPITAL FLOW AVERAGES FOR STATED YEARS.

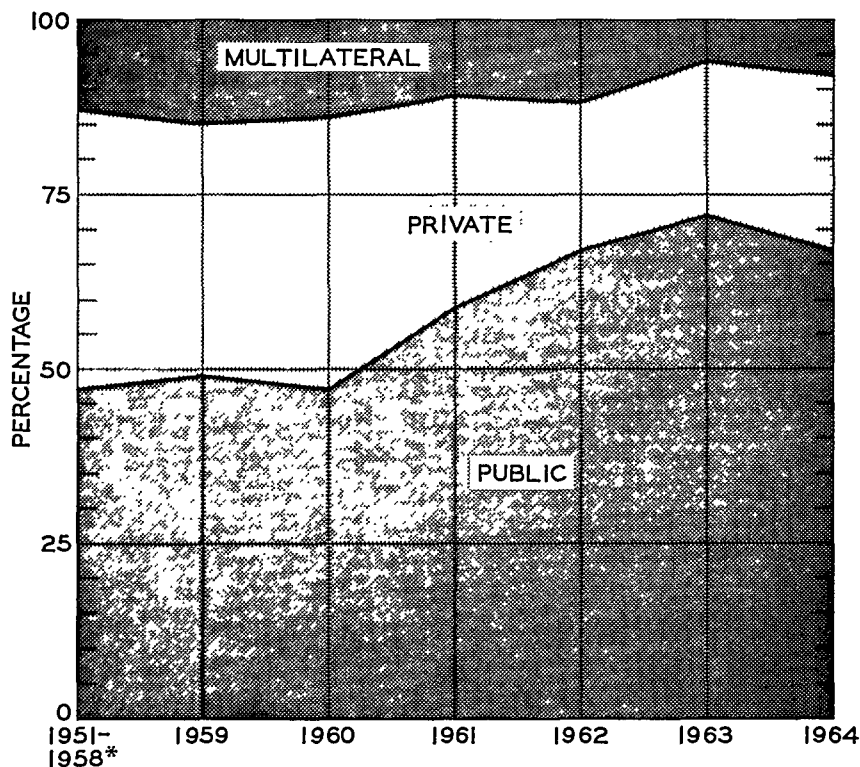
CHART 1

opposite). Unfortunately, the future trend of private investment cannot be predicted at this time with the presently available statistical data. Nevertheless, since official donations seem unlikely to increase substantially beyond their present level for political reasons,⁹ and since the cumulative costs of maintaining debt even at the minimum multilateral agency rates appear to be skyrocketing,¹⁰ it is obvious

⁹ Wiggins, *Foreign Assistance and Political Development*, in *DEVELOPMENT OF THE EMERGING COUNTRIES—AN AGENDA FOR RESEARCH* 181-214 (The Brookings Institution 1962). See Morgenthau, *A Political Theory of Foreign Aid*, in *DEVELOPMENT AND SOCIETY* 348-64 (Novak & Lekachman eds. 1964) for the author's proposals in this area.

¹⁰ SHONFIELD, *THE ATTACK ON WORLD POVERTY* 148-50 (1961). But see MEIER, *LEADING ISSUES IN DEVELOPMENT ECONOMICS* 148 (1964), who argues that the

NET FLOW OF LONG-TERM CAPITAL FROM DEVELOPED TO UNDERDEVELOPED COUNTRIES 1951-1964



*VALUES SHOWN ON THIS COORDINATE REPRESENT CAPITAL FLOW AVERAGES FOR STATED YEARS.

CHART 2

that the economic need for expanding the flow of private capital has become paramount.

The significant "fringe-benefits" which private capital produces in recipient countries further justify efforts to increase export flow. Private capital provides the countries with sorely needed foreign exchange. Official donations or loans may require the recipient to

export surplus that would be necessary to cover costs will be created as long as capital is distributed according to its most productive use and the excess spending associated with inflation is avoided; Khatkhate, *Debt-Servicing as An Aid to Promotion of Trade of Developing Countries*, 18 OXFORD ECONOMIC PAPERS 224 (1966), where the author suggests that it is possible to promote the exports of developing countries by linking their repayment liabilities to their exports.

spend them in the country of the grantor.¹¹ Investors, however, place no such restrictions on their own capital and will tend to purchase goods and services locally to the extent that adequate supplies of acceptable quality are available. If such goods and services are not available at the outset of the investment, the demand for them will frequently prove to be so great that considerable quantities of local capital will be drawn out to provide them.¹² This effect will certainly be most welcome in any country. Reinvested earnings from such investments have in themselves constituted a good source of capital. And if the investment is in the form of equity rather than debt, industrial enterprises in countries which traditionally suffer from an oppressive debt/equity ratio will be able to refinance on more attractive terms.

The decline in the quantity of private funds available to underdeveloped nations does not appear to be part of any worldwide trend. On the contrary, during the fifties, the net international flow of long-term private capital more than doubled.¹³ As noted earlier, during the same period, the volume of transactions with the underdeveloped nations remained relatively constant.¹⁴ Although current statistics are not available on the flow of capital among the developed countries themselves, it can be safely assumed that this circular flow continues to exceed the amount that seeps out to the underdeveloped countries.¹⁵ Furthermore, when the amounts of private capital received by each of the underdeveloped countries are examined, repetitive patterns appear.¹⁶ Among the Asian nations, for example, India, Israel, Malaysia, Pakistan, and Thailand are the perennial favorites. In Africa, Nigeria is the only country which has not shown a recent decline in foreign private capital. Total flow of private capital to all Latin American

¹¹ MASON, FOREIGN AID AND FOREIGN POLICY 41-51 (1964). But see SHONFIELD, *op. cit. supra* note 10, at 160 where the author makes the case for more tied loans in order to secure the cooperation of host countries in solving the donor countries' balance of payments problems.

¹² See, e.g., Diamond, *The Role of Private Institutions in Development Financing*, Int'l Develop. Rev., March 1965, p. 10. This raises the interesting question whether investment should be placed in social overhead capital projects (public utilities) to invite the establishment of new industries or immediately into "directly productive activities" (industries) to compel the establishment of both public utilities and supportive industries. For an espousal of the latter position, see generally HIRSCHMANN, *THE STRATEGY OF ECONOMIC DEVELOPMENT* (1958).

¹³ See *International Flow of Long-Term Capital and Official Donations, 1951-1959*, U.N. Doc. No. E/4079/ Rev. 1 (1965), at 37.

¹⁴ See text accompanying note 2 *supra*.

¹⁵ See BENHAM, *op. cit. supra* note 1, at 65.

¹⁶ Data on the flow patterns of individual countries is taken from *Financing of Economic Development*, U.N. Doc. Nos. E/4079/ Rev. 1 (1965), table 12, p. 46.

countries, except Surinam and Peru, has decreased over the past few years and Venezuela has been experiencing a continual outflow of private capital. The only Latin American country to show a relatively high and relatively constant receipt of foreign private capital has been Mexico.

II. CAUSES OF THE DECLINE IN FOREIGN PRIVATE INVESTMENT

Why have some private investors chosen to place their funds in some foreign countries but not in others? In seeking an answer, it is perhaps helpful to restate the question as "What makes the 'investment climate' more attractive in one country than in another?" This so-called "investment climate" is by no means a vague emotional reaction experienced by an investor. It is rather the objective estimate of several observable attitudes which greet the prospective investor. The key elements comprise (1) a national policy favoring free enterprise, both foreign and domestic; (2) a reasonable outlook for political stability; (3) willingness of governments to honor their own commitments and those of prior governments; and (4) a sound government economic policy.¹⁷ When any of these is lacking, the investor senses risk. And when the risk of loss counterbalances the expectation of profits, the investor turns his attention to another country.

Risk of loss is, of course, an understandable fear on the part of the investor. Uncompensated, or partially compensated, expropriation has occurred so often in the last ten years—in Egypt, Indonesia and Cuba, to mention but a few instances—that investors are unable to justify further investments in these or in similarly situated countries.¹⁸ When they do place capital in high-risk areas, a related problem arises. The investor can justify high risks only by the possibility of high profits. The existence of a wide profit margin in alien-owned industry is never appreciated by an underdeveloped country, and so the probability of expropriation may even increase as investors feel that risk increases. A circle of investor apprehension and local reaction may be established, in which nationalization becomes an inevitable result.

At the same time, it must be realized that risk of loss reflects only one side of the problem. The host nations are currently in the process of developing their own political and legal structures, and a flexible policy toward private property, whether owned by nationals or by

¹⁷ Ray, *Law and the Perfecting Process*, in SYMPOSIUM ON RIGHTS AND DUTIES OF PRIVATE INVESTORS ABROAD 31 (1965).

¹⁸ ALPERT, *op. cit. supra* note 1, at 234.

foreigners, is of prime importance.¹⁹ Faced with official insistence on the right of the State to acquire private property subject to few restraints in the nature of due-process, foreign private parties find they can do little to create an investment climate attractive to themselves. An occasional exception may occur when large companies possess essential skills or marketing contracts relating to a product which is, or will be, the mainstay of the local economy.²⁰ The underdeveloped country in such a setting finds itself in a monopsonistic situation and may be forced to guarantee local stability in exchange for the lucrative purchase agreements. Such situations become rarer all the time. The most that the investor can generally hope for is that the new nations will eventually develop the requisite respect for property and political stability. Certain steps, however, can be taken by the interested nations to encourage the flow of private investment into these unattractive areas. Proposals of great variety have been urged by both capital importers and exporters. These have, for the most part, tried to generate an attitude of respect toward investment in nations not yet ready to accept it. In so doing, they have unfortunately fallen short of their mark of reduction of risk.

III. LEGAL APPROACHES

One means of focusing on the often diverging interests of the investor and the host nation is to examine programs designed, in one way or another, to increase investment of private capital in underdeveloped nations. Existing programs may be conveniently placed in three groupings: (a) unilateral measures, (b) bilateral agreements and (c) multilateral conventions.

A. Unilateral Measures

These are of two types: state legislation and insurance schemes. Several capital importing states have enacted, on their own, legislation to encourage investment.²¹ Such enactments typically take the form

¹⁹ Murphy, *State Responsibility for Injuries to Aliens*, 41 N.Y.U.L. REV. 125, 130-31 (1966).

²⁰ See Note, *Avoiding Expropriation Loss*, 79 HARV. L. REV. 1666, 1673 n.38 (1966).

²¹ The more important of these have been catalogued in *Financing of Economic Development*, U.N. Doc. No. E/3665/ Rev. 1, Ann. II (1962), and U.N. Doc. No. E/3905, at Add. 1/Ann. I.

Occasionally, developed nations have granted significant tax-relief measures to their investors operating in underdeveloped countries. See, e.g., INT. REV. CODE OF 1954, §§ 921-922 for the benefits afforded a "Western Hemisphere Trading Corporation," and § 902 for provisions generally applicable to taxpayers with operations in underdeveloped countries.

of general statements expressing the interest of the host country in attracting foreign capital and a plan of tax concessions. Some countries even go so far as to guarantee freedom from expropriation. The guarantee, however, is only as good as the word of the country itself. If the country decided to nationalize, it is unlikely that such a guarantee would provide an obstacle to its plans. It is most unlikely that such legislation would in itself overcome a country's unhealthy reputation. In fact, such legislation, while it may be very charitable on its face, is frequently directed toward only one industry or even only one company which is operating under a closed concession.²²

One fairly recent legislative proposal by the country of Uganda provides a type of arrangement that may in fact increase the probability of an investor receiving compensation after expropriation.²³ The act provides for a system of registrations of foreign investments and the issuance of certificates for those activities which will aid in the economic development of Uganda. These certificates show on their face the total assets of the enterprise and the portion of these assets which is represented by foreign capital. There are provisions for the subsequent amendment of these figures when a substantial variation in the value of the assets occurs. The act reserves the right of the government to acquire such assets by eminent domain in accordance with a provision of the Uganda Constitution which contains a detailed description of the limited situations in which the government may take the property of a private individual, citizen or alien.²⁴ These constitutional limitations reflect the typical restrictions placed on governments in common law countries. If an approved investment is taken by the government, compensation will be paid within six months from the date of the taking, in respect to the approved proportion of the valuation specified on the certificate. An investor, finding his property appropriated by the state, is guaranteed access to the Uganda High Court to determine his interest or to challenge the legality of the acquisition or the adequacy of the compensation.

It is true that this legislation is again no more compulsory upon the country of Uganda than its word, but it does reflect a sincere effort on the part of a country to establish a realistic scheme whereby it reserves

²² For the view that such legislation has a positive value to foreign investors by reducing the probability of breach of specific provisions, see Meier, *Legal-Economic Problems of Private Foreign Investment in Developing Countries*, 33 U. CHI. L. REV. 463, 492 (1966).

²³ The Foreign Investment (Protection) Act, [1964], 3 INT'L LEGAL MAT. 1062 (1964).

²⁴ UGANDA CONST. art. 22, in 3 INT'L LEGAL MAT. 1065 (1964).

the right to acquire private property, whether domestic or foreign owned, yet assures the owner compensation in an amount to which he has agreed. Furthermore, should Uganda default on its bargain, the investor would have an arrangement on which to seek redress by local, or via the intervention of his state, international tribunals. The legislation is unfortunately still a unilateral declaration, and no unilateral declaration can provide complete protection to the cautious investor.

The more successful unilateral arrangements have proven to be the insurance plans which are offered by the United States, Japan, and the Federal Republic of Germany to their own investors.²⁵ These are similar in form, and a description of the United States' guarantees will suffice. There are two types: specific²⁶ and extended²⁷ risk. The specific risk insurance guarantees the investor against damages caused by non-convertibility of currency; expropriation; or war, revolution, and insurrection, while the extended risk coverage protects him against general commercial hazards.

Because these programs offer a high probability of compensation in an expropriation situation, they have proven to be very popular.²⁸ They do, nevertheless, suffer from inherent defects. Any insurance plan, by its very nature, substitutes compensation for stability. Investment is encouraged by reducing risk to a particular investor, but the host country may feel little incentive to create a more attractive investment climate through its own efforts. In fact, not only need the country not actively pursue private investment, but it may even allow its treatment of investments and investors to deteriorate to a point at which no private capital would flow into the country, were the foreign insurance programs not in existence. If such a deterioration were to occur it would almost inevitably result in a loss of capital from other uninsured sources, both public and private. Of course, the mere possibility of dissatisfaction of the United States in its role as subrogee may have a certain *in terrorem* effect, and may decrease the possibility of expropriation.

In addition to this fundamental defect, these plans have other short-

²⁵ The three plans are compared in Annex A to I.B.R.D., MULTILATERAL INVESTMENT INSURANCE (1962).

²⁶ U.S.A.I.D., DEP'T OF STATE, SPECIFIC RISK INVESTMENT GUARANTY HANDBOOK (1965) [hereinafter cited as HANDBOOK].

²⁷ U.S.A.I.D., DEP'T OF STATE, AIDS TO BUSINESS (OVERSEAS INVESTMENT) (1965).

²⁸ 778 insurance contracts with a face value of over \$1.4 billion had been written by December 31, 1963. Armstrong, *The United States Government's Investment Guaranty Program*, 20 BUS. LAW. 27 (1964).

comings. They can be very expensive.²⁹ If the project is one that requires a substantial fixed capital investment relative to returns, *e.g.*, a large utility or mining project where before-tax returns are expected to be, say, ten to twelve per cent of the investment, perhaps "sweetened" with a tax concession, the annual premiums may exceed ten per cent of the before-tax returns. (The premiums in the footnoted example varied from 4.5 per cent to 10.5 per cent of current earnings!) This effect is even more discouraging where attempts are made to duplicate the high-volume low-profit types of United States marketing operations, such as supermarkets and "five-and-ten cent" stores. Such insurance costs may gravely affect the economics of the enterprise and may even prevent utilization of the option to insure.

Also, these coverages are designed to encourage new investments and are therefore not available to existing investments.³⁰ This is bad enough, but "existing" is interpreted to mean existing *de jure* rather than *de facto*.³¹ Thus, if the contract is signed, the investment is ineligible even if no transfer of capital has occurred, although there are administrative techniques to avoid this adverse determination. These plans are not available in all underdeveloped countries, nor are all types of coverage available in each country.³² Thus, an investor, even if he is desirous of coverage, may find it unavailable to him.

²⁹ To determine his cost, the investor decides first the maximum amount of coverage that he may desire at any time during the period of the guarantee, and then how much he desires for the present year. The premium for the amount actually in force is $\frac{1}{2}$ of 1% and the premium for the standby coverage (equal to the difference between the maximum amount and amount actually in force) is $\frac{1}{10}$ of 1%. This premium is for *each* of the coverages desired. For example, say an investor plans a \$1,000,000 investment and desires total coverage against expropriation and insurrection when the project is completed, but only \$300,000 at the present due to its present state of development. He also plans to repatriate capital later on in amounts of \$100,000 per annum as profits accrue. His premiums then amount to:

Convertibility: Standby—\$100,000 at $\frac{1}{10}$ of 1% = \$100

In force—0

Expropriation: Standby—\$700,000 at $\frac{1}{10}$ of 1% = \$70

In force—\$300,000 at $\frac{1}{2}$ of 1% = \$1500

Insurrection: Standby—\$700,000 at $\frac{1}{10}$ of 1% = \$700

In force—\$300,000 at $\frac{1}{2}$ of 1% = \$1500

The total annual premium is, at its minimum amount at the inception of the investment, \$4500, or 1.5% of his initial assets. At its maximum, the cost will be $\frac{1}{2}$ of 1% of \$100,000, plus $\frac{1}{2}$ of 1% of \$1,000,000, plus $\frac{1}{2}$ of 1% of \$1,000,000 = \$10,500, or just over 1% of his total assets.

If an investor desires insurance covering *any* conceivable commercial risk, save his own fraud, this can be issued under the extended risk program at a rate of up to 1 $\frac{3}{4}$ % of the insured portion of the investment (75% of the total except in housing investments). This is in place of the specific risk coverage, although that can be used to cover the remaining 25%. Unfortunately, this coverage is available only to A.I.D. approved projects and not to all commercial ventures.

²⁹ HANDBOOK 6.

³¹ *Id.* at 7.

³² *Id.* app. D.

Whether payment will be made in cases of expropriation short of a total taking, *i.e.*, "creeping expropriation," is an unanswered question. Perhaps in keeping with the spirit of the plan it would be, but the insured would have a heavy burden to prove the extent of his losses.³³

B. *Bilateral Agreements*

The typical illustration of these is the *Friendship, Commerce, and Navigation* (F.C.N.) treaties proposed by the United States. Recently, Japan, the United Kingdom, the Federal Republic of Germany, and Switzerland have initiated their own treaties of this variety. These are based upon the principles of national or most-favored-nation treatment.³⁴ It is impractical to discuss any one treaty as being typical of the group because of the variations among their provisions. However, some generalizations can be made.³⁵ Most treaties provide citizens of both signatories the freedoms of travel into, within, and from their territories. They also provide a host of commercial privileges.³⁶ These latter provisions frequently include freedom from unreasonable or discriminatory measures which would impair legally acquired rights or interests; protection and security of property; prompt, adequate and effective compensation in instances where property is taken for a valid public purpose; and national treatment, while engaging in business activities, in acquiring property by any means, with respect to patents and trademarks, as to taxes, as to exchange of funds, and as to import and export regulation.

There is no doubt that these treaties have done much to improve relations and communications between the signatory nations.³⁷ They have also served as an encouragement to investors. They do, however, appear to be of questionable value in resolving an expropriation contro-

³³ The development of more liberal definitions of "Expropriatory Action" in the insurance contracts is illustrated in Miller and Christy, *The United States Government's Investment Guaranty Program*, 2 BUS. LAW. 789, 790 (1964). It is interesting to note that the authors were the chiefs of the Investment Guarantees Division and the Extended Risk Guarantees Division, Agency for International Development.

³⁴ WILSON, UNITED STATES COMMERCIAL TREATIES AND INTERNATIONAL LAW 113 (1960). It is significant to note that the United States has abdicated its traditional espousal of the international standard as the basis of treatment for its citizens and, insofar as this treaty series is concerned, has based liability on more explicit provisions. The current trend is toward guaranteeing treatment "no less favorable than that received by nationals of the other party."

³⁵ See generally, Walker, *Modern Treaties of Friendship, Commerce and Navigation*, 42 MINN. L. REV. 805, 807 (1958).

³⁶ See, *e.g.*, Treaty With Japan [1953], 4 U.S.T. & O.I.A., 2063 T.I.A.S. 2863, 206 U.N.T.S. 143, at 193, arts. I through XIV.

³⁷ Walker, *Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice*, 5 AM. J. COMP. L. 229 (1956).

versy between the two signatories. These treaties are written with broad and ambiguous phraseology and permit potentially wide exceptions. Most of them allow both countries to take whatever measures they deem necessary to protect their "essential security interests."³⁸ *Quaere*: Could not discriminatory and uncompensated expropriations, which are in direct violation of other articles, be justified by this provision under certain circumstances? Significantly, the concept of a "taking" does not appear to be defined with sufficient precision to cover "creeping expropriations." Acquisitions of this type expropriate an investor's property *without* acquiring his legal title. Possible techniques include excessive and discriminatory taxation, denial of access to essential raw materials or to markets, or unreasonable labor regulations. All of these activities presumably could be justified by local courts as measures necessary to protect their "essential security interests." The investor himself has no standing to pursue his claim. His own country must espouse his cause of action and when this occurs his government controls the further course of the litigation. Finally, since only ten of the United States' F.C.N. treaties which have been concluded with developing countries contain provisions relating to compensation upon expropriation,³⁹ the prospective investor is likely to find that the treaty with the country which will be the site of his project does not contain clauses designed to protect his interests. These treaties, being bilateral in nature, have one essential advantage: they are relatively easy to enter into. This feature is retained in the *Proposal*.

C. Multilateral Conventions

At present, there are three significant proposals for multilateral conventions. Two of these have been proposed by the Organization for Economic Cooperation and Development (O.E.C.D.). The first deals with protection of investments, *per se*, and the second is a multilateral insurance scheme. The third proposal, known as the Harvard Draft, also deals with protection of investments in the narrow sense.

³⁸ Pugh, *Legal Protection of International Transactions Against Non-Commercial Risks in International Business Transactions*, in INTERNATIONAL BUSINESS TRANSACTIONS 330 (Surrey ed. 1963). See, e.g., Treaty With Japan, *supra* note 36, at art. XXI(1)d.

³⁹ Ethiopia, Greece, Iran, Israel, Korea, Nicaragua, Pakistan, Republic of China, Republic of Vietnam, and the Sultanates of Muscat and Oman and Dependencies. Vaughn, *Finding the Law of Expropriation: Traditional vs. Quantitative Research*, 2 TEXAS INT'L L. F. 189 (1966).

It was prepared by Professors Sohn and Baxter at the request of the United Nations.

The *Draft Convention on the Protection of Foreign Property* of the O.E.C.D.⁴⁰ was designed almost exclusively to cope with the problems of "creeping expropriation." It rests upon what the O.E.C.D. considers to be a "well-established principle of international law"⁴¹ that a state is bound to respect and to protect the property of nationals of other states by providing (1) fair and equitable treatment, (2) most constant protection and security, and (3) freedom from unreasonable or discriminatory measures. This principle is implemented by the prohibition of "takings" which deprive an investor, directly or indirectly, of his property, unless there exists (1) public interest requiring the taking and due process of law in its accomplishment, (2) an absence of discrimination or acts contrary to another agreement, and (3) provisions for payment of just compensation which is to be of "genuine value" and transferrable without delay. "Property" is subsequently defined to mean all property, rights and interests, whether held directly or indirectly, including the interest which a member of a company is deemed to have in the property of the company.⁴²

The O.E.C.D. Draft, therefore, establishes in each state the same rights and duties with respect to private property as the developed nations have traditionally possessed. Not surprisingly, the underdeveloped nations have staunchly defended their power to develop laws of property as they alone see fit. These laws may or may not turn out to be identical to those of the developed countries. Because the underdeveloped nations view the O.E.C.D. Draft as an attempt to force unpopular legal concepts upon them, it seems unlikely that it will gain wide acceptance.⁴³

The *Harvard Draft*, properly known as the *Draft Convention on the International Responsibility of States for Injuries to the Economic Interests of Aliens*,⁴⁴ is similarly based upon what its authors consider an international minimum standard of protection for private prop-

⁴⁰ 2 INT'L LEGAL MAT. 241 (1963).

⁴¹ *Id.* art. 3, Comment A (1), at 249.

⁴² *Id.* art. 9(c), at 262.

⁴³ Arguments attempting to overcome this fault have been put forth by stating that the O.E.C.D. has developing countries among its members—Greece, Ireland, Spain and Turkey. Cf. A.B.A., PROTECTION OF PRIVATE PROPERTY INVESTED ABROAD 66 (1963). These countries, with the possible exception of Turkey, are at the upper end of any list of developing countries. For a comprehensive analysis of the various criteria for the economic classification of countries, see generally ENKE, ECONOMICS FOR DEVELOPMENT (1963), particularly chs. 2 & 3.

⁴⁴ See Sohn & Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 AM. J. INT'L L. 545 (1961).

erty.⁴⁵ Unlike the O.E.C.D. proposal, the *Harvard Draft* gives the individual investor a direct cause of action.⁴⁶ Like the O.E.C.D. scheme, the *Harvard Draft* provides liberal definitions of both "property" and "taking" and makes a wrongful taking actionable. According to the *Harvard Draft*, a taking (or a using) of the property of an alien is wrongful if (1) it is not for a public purpose clearly recognized as such by a law of general application in effect at the time of the taking, or if it is in violation of a treaty; or (2) if it is not accompanied by prompt payment of compensation in accordance with the highest of the following standards: (a) national treatment, (b) fair market value, or (c) just compensation in terms of fair value if no fair market value exists. A taking, furthermore, includes not only an outright taking, but also any unreasonable interference with the use, enjoyment or disposal of such property. "Property" is defined simply as all movable or immovable property, whether tangible or intangible, and the term includes all industrial, literary and artistic property, as well as rights and interests in any property.⁴⁷

The *Harvard Draft*, although harking to international standards a little more clearly than the O.E.C.D. scheme, still imposes upon potential signatories principles to which they do not, and probably will not, accede. Thus, Sohn and Baxter's proposals likewise would prevent developing nations from developing their own laws as they see fit.

The *International Investment Guarantee Corporation*⁴⁸ was proposed by the O.E.C.D. upon the suggestion of the United Nations Conference on Trade and Development (U.N.C.T.A.D.). It involves the creation of a new corporation, the International Investment Guarantee Corporation, (I.I.G.C.) to operate under the auspices of the International Bank for Reconstruction and Development (I.B.R.D.). Member countries are divided into three groups: (a) capital exporting or "contributing members" who share losses; (b) capital importing or "host countries" who subrogate their rights under the claims to the I.I.G.C. and who agree to settle any claims against them; and (c) consulting members who are merely advisory. The I.I.G.C. would be legally separated from the I.B.R.D. and would be administered by its own council with all member countries entitled to one vote each therein. The guarantee operations would be supervised by a board containing a majority of category (a) members.⁴⁹

⁴⁵ *Id.* at 547.

⁴⁶ *Id.* art. 1, § 2(a), at 548.

⁴⁷ *Id.* art. 10, at 553-54.

⁴⁸ 5 INT'L LEGAL MAT. 92, 94 (1966).

⁴⁹ *Ibid.*

In operation, losses are shared according to a special formula which apportions the loss among those countries which approved the eligibility of the particular investment for guaranties. The first one-half is allocated to those countries which actually purchased guarantees and the second is allocated to those countries which approved the defaulting country for investment guaranties but did not purchase any guarantees in this case. Financing would be strictly by premium and calls; there would be no funding.⁵⁰

This scheme is, naturally enough, favored by the host country bloc, but has been criticized by some of the contributing members.⁵¹ There appear to be some countries who want no part of the responsibility for sharing another's losses. Taking the insurance plan from a national operation to an international one would perhaps overcome some of the criticisms levied against the unilateral approaches. Such a plan might mollify somewhat a host country's attitudes toward expropriation, but is unlikely to cause a major shift in its political views towards investors if it is not paying the premiums. It is too early to evaluate this proposal thoroughly, but it does not appear to have the universal acceptance necessary for adoption. The O.E.C.D. may have overreacted to criticisms of their prior *Draft Convention*, for now it is the capital exporters that consider the I.I.G.C. treaty one-sided.

The I.B.R.D. itself has come up with what appears to be a more promising approach in its *Convention on the Settlement of Investment Disputes between States and Nationals of other States*, of March 18, 1965. This *Convention* calls for the establishment of a "Centre for Settlement of Investment Disputes," which shall permanently maintain a panel of conciliators and arbitrators. Jurisdiction "shall extend to any legal dispute arising directly out of an investment"⁵² between a contracting state and a national of another contracting state. Both parties must consent to jurisdiction, and once consent has been given, it cannot be unilaterally withdrawn. Furthermore, once the dispute has been submitted to arbitration, no contracting party may bring an international claim on behalf of its national unless the other state has failed to comply with the award.⁵³ The *Convention* avoids the question of sovereign immunity, and specifically states that any of its provisions

⁵⁰ *Ibid.*

⁵¹ *Ibid.*

⁵² I.B.R.D. Convention, art. 25, March 18, 1965.

⁵³ *Id.* art. 27(1).

⁵⁴ *Id.* art. 55. But see Note, 79 HARV. L. REV. 1666, 1669 (1966), wherein it is suggested that the language *might* be interpreted as allowing the defense of sovereign immunity from jurisdiction.

relating to enforcement of an award shall not be construed as derogating the internal laws of a contracting state relating to immunity.⁵⁴ In absence of any agreement as to the applicable rules of law, however, the Centre's tribunal will apply the law of the host state, including its rules on conflict of laws, and applicable international law.

The real advantage of this plan is that it gives the individual claimant a cause of action. He need no longer convince his own state to espouse his claim and then commit the entire course of the proceedings to its hands. Once his state has acceded to the *Convention*, he may request the Centre to exercise jurisdiction.⁵⁵ Of course, consent of the defaulting state must be secured, but, at least in major projects where direct dealings with the state are involved, that can be acquired during the original contract negotiations. It may also be that some acceding states can be persuaded to pass legislation embodying a general consent to jurisdiction.

Another distinct advantage is that the plan calls for arbitral and not judicial proceedings. This will give the proceedings considerably more flexibility and will ameliorate several onerous burdens of proof normally borne by claimants in disputes of this kind. Along with arbitration, conciliation is provided for,⁵⁶ and hopefully many disputes could be resolved at that stage. The Centre's tribunal is utilized under the *Proposal*.⁵⁷

IV. PROBLEMS ENCOUNTERED IN LITIGATION FOLLOWING EXPROPRIATION

The foregoing has examined the relative strengths and weaknesses of the various programs aimed at increasing private investment. The often-divergent interests of the foreign investor and the developing nation have been indicated. Key elements in expropriation controversies are now treated and solutions suggested.

A. Access

Unless a treaty has given the investor access to the courts, he generally must be content to allow his own nation to prosecute his claim for him. This involves first persuading his nation to espouse his claim and then surrendering the entire course of the litigation to

⁵⁴ I.B.R.D. Convention, art. 36, March 18, 1965.

⁵⁵ *Id.*, art. 1(2).

⁵⁷ On September 14, 1966, the Convention received its twentieth ratification and went into effect on October 14, 1966. Am. Soc. Int'l Law, Letter to Members, October 1966.

it. As a rule, the United States will not intervene in cases involving breaches of contract between a United States citizen and a foreign state, absent a strong showing of a denial of justice.⁵⁸ The Government refuses to consider itself a collection agency, and will not enforce contractual undertakings freely entered into by its nationals. If the need of the underdeveloped nations for more private capital forces a change in the political attitudes of the United States, this restraint may be lifted, but thus far there have been no indications to that effect.

If access to a foreign court cannot be obtained by either the individual or his state, recourse must be had to the International Court of Justice. Here again, the state, not the injured party, must be the prosecutor.⁵⁹ Furthermore, not all states have accepted the compulsory jurisdiction of the International Court of Justice in matters concerning international law or obligations.⁶⁰ By virtue of the so-called "Connally Amendment,"⁶¹ the United States does not submit to the compulsory jurisdiction of the international Court of Justice in matters which it decides are within its domestic jurisdiction. Consequently, under generally accepted views as to reciprocity of obligations, a respondent state, which did in fact accept the compulsory jurisdiction of the court (*i.e.*, the power of the court to decide for itself whether the matter falls within its jurisdiction, and if jurisdiction is found, to determine the substance of the dispute) can still refuse to submit to the jurisdiction of the court in a matter which it considers to be within its own domestic jurisdiction when the United States is complainant.

Assume the claimant preferred to seek satisfaction through arbitration, it will be difficult to get the expropriating state to agree to it after the fact. Some countries flatly refuse to have anything to do with arbitration. Saudi Arabia, for example, has declared that none of its state agencies may conclude contracts providing for arbitration save in concession cases wherein it is to the utmost advantage of the state to submit to arbitration.⁶²

Access is clearly desirable from the investor's point of view and,

⁵⁸ 5 HACKWORTH, INTERNATIONAL LAW 610 (1943).

⁵⁹ Stat. Int'l Ct. Just. (1945), art. 34, para. 1.

⁶⁰ *Id.* art. 36, para. 2. This is the "Optional Clause."

⁶¹ 61 Stat. 1218 (1946), 15 DEP'T STATE BULL. 452. The "Amendment" qualifies the acceptance by the United States of the jurisdiction of the International Court of Justice as required by its statute, note 60 *supra*.

⁶² Council of Ministers Dec. No. 58 (17/1/1383), 25 June 1963, 3 INT'L LEGAL MAT. 45 (1964).

there appears to be no reason why a treaty cannot grant the individual claimant standing to prosecute his own claim. As to the forum for prosecuting claims, however, litigation in the courts of foreign countries seems ineffective.⁶³ The I.B.R.D. Centre, discussed earlier, has far more appeal to investors and therefore it is the forum adopted in the *Proposal* for settlement of disputes.⁶⁴ Access to all courts is specifically denied.⁶⁵

B. Sovereign Immunity

Sovereign immunity is generally considered to be waivable by international agreement.⁶⁶ The United States has taken the position that sovereign immunity may be expressly waived by either treaty or contract.⁶⁷ The effect of this waiver depends considerably upon the location of the forum. If suit is instituted in the expropriating state and waiver is retracted,⁶⁸ probably little can be done, other than appeal of the decision to the International Court of Justice. The same would apply if the waiver did not exist and the local courts allowed the plea of sovereign immunity to be interjected. On the other hand, if suit were to be brought in the United States, and an expression of waiver did exist, the courts would not honor a request of retraction.⁶⁹ If no agreement had been reached beforehand, however, the defense of sovereign immunity would be in dispute. Since the issuance of the "Tate Letter,"⁷⁰ the United States has adhered to the "restrictive theory" of sovereign immunity in acting upon requests of foreign governments for immunity. The "restrictive theory" holds that a grant of immunity will be issued only if the act in question is a public and not a private act of the state. This determination is to be made by the executive and its decision transmitted to the courts. The

⁶³ See generally Rivkin, *International Litigation and Arbitration*, in *INTERNATIONAL BUSINESS TRANSACTIONS*, *op. cit. supra* note 38, at 962. The author investigates problems of procedure as well as of enforcement.

⁶⁴ *Proposal*, art. IV, para. A.

⁶⁵ *Id.* art. IV, para. C.

⁶⁶ See generally *Waiver of Sovereign Immunity*, 6 HARV. INT'L L. CLUB J. 189 (1965).

⁶⁷ RESTATEMENT (SECOND), FOREIGN RELATIONS LAW OF THE UNITED STATES § 70 nn.1 & 2 (1965) [hereinafter cited as RESTATEMENT]; Comment, *Sovereign Immunity—Waiver and Execution: Arguments from Continental Jurisprudence*, 74 YALE L.J. 887, 895-96 (1965).

⁶⁸ British Courts specifically recognize the right of a sovereign to retract its waiver of immunity during the proceedings. *Kahan v. Pakistan Federation*, [1951] 2 K.B. 1003, 1012. It is not unlikely that courts of underdeveloped Commonwealth nations will follow this view.

⁶⁹ *Flota Maritima Browning de Cuba, S.A. v. Motor Vessel Ciudad de la Habana*, 335 F.2d 619, 625 (4th Cir. 1964).

⁷⁰ 26 DEP'T STATE BULL. 984 (1952).

courts have universally deferred to the decisions of the Department of State in these matters.⁷¹

Since a waiver of sovereign immunity is to be exacted from each signatory to the *Proposal*,⁷² it is important to determine whether a country other than the United States can waive its immunity by treaty. There is, unfortunately, no rule of law precisely in point. The tendency of nations to adopt the "restrictive theory" is indicative of a trend toward the acceptance of suit in all commercial matters without prior inquiry into the nature of the litigation.⁷³ If a state can adopt this procedural device (*i.e.*, the "restrictive theory") as part of its jurisprudence, there appears to be no reason why it could not agree to adopt it in a treaty.⁷⁴ The ability of a state to waive its immunity in this manner is by no means settled, however, and the only safe course appears to be to determine the capacity of each potential signatory.

C. *The Act of State Doctrine*

An alien whose property has been expropriated and who is seeking compensation in the courts of his own country may find his remedies barred by the act of state doctrine which prohibits the courts of one state from sitting in judgment upon the acts of another state committed within the latter's territory.⁷⁵ If the doctrine is applicable, compensation is obtainable only through political channels. The doctrine is not a rule of international law, but a policy of judicial restraint and deference to the executive in foreign affairs which has been accepted by only a few politically advanced Western nations.⁷⁶ It was adopted by the United States for the first time in *Underhill v. Hernandez*.⁷⁷

⁷¹ This procedure was followed in the recent case of *Rich v. Naviera Vacuba S.A.*, 295 F.2d 24 (4th Cir. 1961). The case is strongly criticized by Lillich, who refers to it as one which "bids fair to become one of the international legal monstrosities of American courts for the 1960's" because of the insistence of the judiciary to defer to the executive position which fluctuated with the political situation. LILlich, *THE PROTECTION OF FOREIGN INVESTMENT* 17 (1965).

⁷² *Proposal* art. IV, para. D.

⁷³ See Note, *Sovereign Immunity of States Engaged in Commercial Activities*, 65 COLUM. L. REV. 1086 (1965). A notable exception is the U.S.S.R. The English position is presently unclear.

⁷⁴ It is interesting to note that most of the recent F.C.N. treaties provide for waiver of immunity for state-owned commercial enterprises. See, *e.g.*, Treaty With Japan, *supra* note 36, art. XVIII, para. 2.

⁷⁵ See generally Domke, Fridmann & Henkin, *Act of State: Sabbatino in the Courts and in Congress*, 3 COLUM. J. INT'L L. 90 (1965).

⁷⁶ See generally Paul, *The Act of State Doctrine: Revived but Suspended*, 113 U. PA. L. REV. 691 (1965).

⁷⁷ 168 U.S. 250 (1897). For an excellent discussion of this case, see Paul, *supra* note 76.

The degree of confusion and uncertainty which this doctrine adds to an already complex area of the law is well illustrated by the recent *Sabbatino* litigation⁷⁸ and legislation.⁷⁹ The doctrine was brought up during the controversy in the United States courts over funds paid by an agent of the Cuban government for a commercial sale which took place at exactly the same time as the Cuban nationalizations. The Supreme Court, reversing the holdings of the district and appellate courts, refused to inquire into the legality of the seizures by Cuba under international law. Instead, the Supreme Court created a variant of the *Underhill* approach, which prohibited an inquiry into the legality of "a taking of property within its own territory by a foreign . . . government . . . in the absence of a treaty or other unambiguous agreement regarding controlling legal principles."⁸⁰ For present purposes the critical question is, "What constitutes an 'unambiguous' agreement regarding controlling legal principles?" It would appear from the language in the case that an injured party, without benefit of a narrow treaty provision specifically delimiting his cause of action, will have an arduous task establishing "controlling legal principles" in order to persuade the court to inquire into the validity of the taking.

The *Sabbatino* decision has now been abrogated, at least in part, by legislation. The *Sabbatino Amendment* reverses the presumptions of the *Sabbatino* decision upon which the courts will investigate the validity of the taking. Since the act of state doctrine is a matter of judicial deference to the executive, it makes a great deal of difference whether the court presumes that it can act absent executive disapproval, or presumes that it cannot act absent executive approval. The presumption, in this country, has always been the latter, and the executive approval has been known as the *Bernstein Exception*.⁸¹ The existence or non-existence of *Bernstein Letters* figured heavily in the controversy in the lower courts,⁸² but any possibility of existence of such executive authority to proceed was retracted from issue before

⁷⁸ *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964), reversing 307 F.2d 845 (2d Cir. 1962), which aff'd 193 F. Supp. 375 (S.D.N.Y. 1961). The case on remand is reported *sub nom.*, *Banco Nacional de Cuba v. Farr*, 243 F. Supp. 957 (S.D.N.Y. 1965).

⁷⁹ Subsection 301(d)(4) of the Foreign Assistance Act of 1964, 78 Stat. 1013, 22 U.S.C.A. § 2370(e)(2) (Supp. 1965). Hereinafter referred to as the *Sabbatino Amendment*.

⁸⁰ 376 U.S. at 428.

⁸¹ The name of the exception comes from the *Bernstein* litigation: *Bernstein v. Van Heyghen Freres S.A.*, 163 F.2d 246 (2d Cir. 1947), cert. denied, 332 U.S. 772 (1947); *sub nom.* *Bernstein v. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij*, 210 F.2d 375 (2d Cir. 1954); Comment, 62 COLUM. L. REV. 1278 (1962).

⁸² 193 F. Supp. at 381; 307 F.2d at 858, 859.

the Supreme Court by the Department of State.⁸³ Motivated in part by the *Sabbatino* controversy, Congress formally enacted the former of the two presumptions, *i.e.*, that the courts *shall* proceed with an inquiry into the merits of a claim based upon "an act of . . . state in violation of the principles of compensation and the other standards set out in this subsection."⁸⁴ The future of the *Sabbatino Amendment* is presently uncertain, as it is being challenged on the remand by the defendants.⁸⁵ The first attack on the amendment in the district court, which proved to be unsuccessful, was based on the constitutional grounds of deprivation of property without due process of law and legislative interference with executive and judicial responsibilities. The district court felt constrained, however, to enter a judgment until the Department of State had sufficient opportunity (sixty days) to submit a formal suggestion of immunity via a "reverse-twist" *Bernstein Letter*.⁸⁶ The opportunity was formally declined and the district court accepted the determination of the court of appeals in the initial litigation as to the validity of the takings under international law.⁸⁷

It should be remembered that the *Sabbatino* decision and amendment are quite narrow in scope. They both deal with the rights of courts to question the validity of a taking of property by a foreign state within the territorial confines of that state. An obvious means of extraction from the legal quagmire is to assume that all takings of property by a foreign state within its territory are *per se* legal. This position is by no means unknown to international law and will be developed further in the next section.⁸⁸

D. National Treatment vs. The International Standard of Justice

In arriving at a solution to any international dispute, the deciding tribunal must measure the behavior of the parties against some standard of action. Just what the standard should be has been the subject of a lively dispute between the two basic positions, national treatment and the international standard.⁸⁹ The international standard is simply

⁸³ Memorandum for the United States, p. 7, *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964).

⁸⁴ *Sabbatino Amendment*.

⁸⁵ *Banco Nacional de Cuba v. Farr*, 243 F. Supp. 957 (S.D.N.Y. 1965).

⁸⁶ 243 F. Supp. at 981. Since communications from the Department of State conveying executive approval to proceed with litigation were called *Bernstein Letters*, it appears proper to refer to communications conveying executive disapproval as "reverse-twist" *Bernstein Letters*.

⁸⁷ See 60 AM. J. INT'L L. 107, 120 (1966).

⁸⁸ See FRIEDMANN, EXPROPRIATION IN INTERNATIONAL LAW 142 (1953).

⁸⁹ RESTATEMENT § 165, comment a.

the amalgamation of applicable principles which have been derived from all available sources of international law; national treatment is the level of treatment which each nation elects to dispense to its own citizens. The controversy focuses upon the remedies available to an alien when he feels that a foreign state has deprived him of his rights.

The international standard is deficient in two respects: it is vague, and it is not universally accepted.⁹⁰ A distinct international standard may make some sense in matters of human rights,⁹¹ but it is apt to generate more heat than light in economic controversies. Basic principles of contract have been almost universally adopted, and probably no maxim is more catholic than *pacta sunt servanda*. In other words, if a state honors its obligations at all, national treatment in commercial matters will probably deviate very slightly, if at all, from the international standard. Since any benefit hoped for with the international standard is apt to disappear in litigation, and since the national standard has the advantage of predictability, the latter is the standard adopted in the *Proposal*.⁹²

In expropriation cases, the rights of the investor may differ when the acts of the state are judged by differing standards. Since acts of expropriation are contrary to international law,⁹³ they are in derogation of the international standard. Fundamental to the establishment of a claim under the national standard, however, is discrimination. The investor must have been treated differently from other investors, domestic or foreign, who had been similarly situated prior to expropriation. The thesis of the *Proposal* is that the host countries have the right to acquire property at will, provided the investor is properly compensated for his loss. At this point, therefore, questions of discrimination may arise only in regard to compensation since the state has the right to acquire any property it desires, even if such acquisition is discriminatory.

Certain exceptions to the duty to compensate, however, are set forth in the *Proposal*.⁹⁴ One exception occurs when the state nationalizes *all* private property; another when it nationalizes an entire industry. There is, of course, no possibility of discrimination occurring in a total nationalization of all property, but a distinct possibility of dis-

⁹⁰ See RESTATEMENT § 165, comments *a* and *d*.

⁹¹ *E.g.*, in the areas of judicial administration, practice of religion, or freedom from slavery.

⁹² *Proposal* art. II, paras. B, C.

⁹³ See RESTATEMENT § 185.

⁹⁴ *Proposal* art. III, para. B.

crimination exists in a nationalization of an industry. For example, a nationalization of the copper industry, would be discriminatory if only one enterprise existed in the industry and it were alien owned.⁹⁵ Since the state is freed from the obligation to compensate in this case, it is necessary to insist that a nationalization of an industry, as well as compensation after nationalization, be free from discrimination.

It should be noted that investors have been formally accepting the national standard of treatment throughout the last century. Such acceptance is usually accomplished via a clause in the contract between the investor and the state in which the investor agrees to be considered a national for all matters pertaining to the contract, and also renounces any right or intention to seek intervention by his own state before an international tribunal in any matter arising out of the investment. These clauses are usually referred to as "Calvo Clauses"⁹⁶ whose effectiveness, although formally denied by the United States ever since their inception, has been almost universally accepted by the Latin American countries.⁹⁷ In fact, the United States has been loosening its position somewhat since the *North American Dredging* case of 1927.⁹⁸ Although the official United States position has followed the minority opinion of Commissioner F. K. Nielsen in the *International Fisheries* case,⁹⁹ in practice, the Department of State has given limited effect to the "Calvo Clause."¹⁰⁰ The *Restatement* has adopted this more liberal Department of State position and relieves a state of responsibility for economic injury to an alien after an agreement to that effect if the alien does, in fact, receive national treatment, the conduct of the state does not violate any international agreement, and the alien is afforded a *bona fide* remedy under the laws of the state.¹⁰¹ This position is incorporated into the *Proposal* which, in essence, contains a "Calvo Clause" to which all investors registering under the agreement must adhere.¹⁰²

⁹⁵ A nationalization decree of this type would not be discriminatory in its "form," but would be in "fact." This is the reason for the language of art. III, para. B, § 2 of the *Proposal*.

⁹⁶ Metzger, *Property in International Law*, 50 VA. L. REV. 594, 598 (1964).

⁹⁷ 5 HACKWORTH, INTERNATIONAL LAW 635 (1st ed. 1943).

⁹⁸ United States (North American Dredging Co. of Texas) v. United Mexican States, General Claims Commission, Opinion 21 (1927), in BISHOP, CASES ON INTERNATIONAL LAW 710 (1962).

⁹⁹ General Claims Commission, Opinion 207 (1931), in BISHOP, CASES ON INTERNATIONAL LAW 716 (1962).

¹⁰⁰ RESTATEMENT § 202, Reporter's note.

¹⁰¹ RESTATEMENT § 202.

¹⁰² Proposal art. II, paras. B, C (national treatment); art. IV, para. C (non-intervention).

E. The Right to Acquire Property and the Definition of "Value"

All of the documents previously discussed have looked upon takings of property as capable of being either right or wrong under international law. The *Proposal*, on the other hand, grants each country the right to acquire private property at will, and every taking is therefore right under international law, *ab initio*.¹⁰³ Each acquisition of property, however, carries with it a duty to compensate the investor for his property,¹⁰⁴ save in certain exceptional situations.¹⁰⁵ Contrast this stand with the *Restatement* position which holds that a taking is wrong if (a) it is not for a public purpose, (b) there is no reasonable provision for compensation or (c) the property is in transit through the taking state.¹⁰⁶

It can be seen that under the *Proposal*, no investigation need be made into the nature of the taking. Compensation becomes automatically due upon determination that an acquisition occurred, and, as will be shown *infra*, the amount of compensation will have been agreed to beforehand. By contrast, the *Restatement* requires a decision upon the merits as to the purpose of the taking and the provisions for compensation in order to determine the validity of the taking. Hence, in the *Restatement's* view, it is the validity of the taking, not the taking itself that activates the requirement for compensation. *It is suggested that this approach focuses on the wrong issue.* The investor seeks compensation regardless of the reason for the taking. The expropriating nation is not desirous of litigating the motives behind its behavior, and its willingness to pay would seem at best unaffected by resolution of such an issue. Thus, attention should be directed at the terms and conditions of compensation in the event of expropriation, and not on the act itself. The position is illustrated by comparing it with the *Restatement* approach.

The public purpose or public utility principle is so questionable today that it can hardly be considered a rule of law.¹⁰⁷ The authors of the *Harvard Draft* themselves admit that they have retained the criterion solely because of the frequency with which it has been employed in the past, and this retention was accomplished only "with

¹⁰³ *Id.* art. III, para. A.

¹⁰⁴ *Id.* art. III, para. B.

¹⁰⁵ *Id.* art. III, para. B, §§ 1, 2, 3.

¹⁰⁶ RESTATEMENT § 815.

¹⁰⁷ See generally WHITE, NATIONALIZATION OF FOREIGN PROPERTY 145-50 (1961); RESTATEMENT § 185, comment b.

some hesitation."¹⁰⁸ The previous use of the principle, moreover, has been confined exclusively to inclusion in treaties; it has never formed the basis of a legal decision concerned with a taking of property. Perhaps when the concepts of capitalism and private property were more universally espoused than they are today, the principle had relevance. With a significant percentage of the world operating under socialist or communist legal systems, the principle appears to have limited utility in international controversies.¹⁰⁹

The question to be answered, however, is, "Should the principle of public utility be the criterion of the validity of a taking of the property of an alien by a state?" The answer is an unqualified "No" for two reasons. First, the principle is not necessary to accomplish a proper protection of alien property, and secondly, it adds an extremely cloudy issue to an already complex controversy. Any protective scheme based on something other than sheer respect for property is compensatory in nature. The *Harvard* and *O.E.C.D. Drafts* and the *Restatement* all provide for some form of payment to the investor for his loss. Yet all require an establishment of wrongfulness before the investor has a claim. Under the *Proposal*, the investor simply establishes his loss and he is then automatically entitled to compensation. The unnecessary and confusing question of the purpose of the taking is avoided. By focusing solely on compensation, it becomes clear that what is needed is a framework within which the investor's economic interest can be determined with precision. To date, this problem has been largely neglected.¹¹⁰

The *Restatement* calls for a reasonable provision for compensation. "Just compensation" is defined as being adequate, prompt, and effectively realizable.¹¹¹ "Adequacy" is further defined as being reasonable under the circumstances, according to the "international standard of justice," and under ordinary circumstances, equal to the full value of the property.¹¹² "Reasonable promptness" means promptness that is reasonable under the international standard.¹¹³ "Effectiveness" means cash or property readily convertible into cash of the alien's state.¹¹⁴ It appears impossible to draw any standards which might be useful in an actual determination of compensation from the above definitions. These definitions are no more than the furthest refinement thus far of

¹⁰⁸ Sohn & Baxter, *supra* note 44, explanatory note to art. 10, 55 AM. J. INT'L L. 545, 556 (1961).

¹⁰⁹ See note 106 *supra*.

¹¹⁰ Metzger, *supra* note 96, at 602.

¹¹¹ RESTATEMENT § 187.

¹¹² *Id.* § 188.

¹¹³ *Id.* § 189.

¹¹⁴ *Id.* § 190.

the "adequate, effective, and prompt" provision of the United States-Mexican correspondence of 1938,¹¹⁵ one of the most overworked pieces of communication in the entire field of international law. Given the duty to compensate, there can be no questioning the objective of these standards; the problem lies solely in their failure to achieve any workable definitions.

The last two aspects of the *Restatement* definition of "just compensation" are relatively simple to improve. "Prompt" could easily be defined as a fixed amount of time, say six months, subject to contractual amendment. The definition of "effectively realizable" could be changed from being "readily convertible into cash of the alien's state" to "cash of the alien's state." This definition would also serve as a basis for any negotiated modifications. These definitions are adopted in the *Proposal*.¹¹⁶

Unfortunately, "adequacy" has been a very complex matter as is readily illustrated by the classic expropriation controversy, the *Chorzow Factory* case.¹¹⁷ When the court instructed the experts on the matter of assessing damages, apparently it could not decide what was contained in the concept of "adequacy," for in essence it asked:¹¹⁸

- I. A. What was the value on the date of taking of possession of the factory at Chorzow by the agent of the Polish government?
- B. What would the factories have earned (or lost) if the former owners had retained possession from the date of taking to the present?
- II. What would the value at date of judgment be of the factory at Chorzow?

Quaere: What is meant by "value"? Does value mean book value, fair market value, fair value, or what? And once the proper term is chosen, what standards are to be used in determining its actual dollar equivalent? The inability of the court in the *Chorzow Factory* case to do more than issue "informative" instructions on evaluating the confiscated property stemmed from its own inability to define "value"

¹¹⁵ The correspondence took place between Secretary of State Hull and the Mexican Ambassador, commencing on July 21, 1938. The entire series is contained in 3 HACKWORTH, *INTERNATIONAL LAW* 655-65 (1942), U.S. Dep't of State, 19 Press Releases 50, 136, 139, 165 (1938), and BISHOP, *CASES ON INTERNATIONAL LAW* 677-86 (1962). The quotation comes from the Secretary's letter of August 22, 1938.

¹¹⁶ Proposal art. III, para. E.

¹¹⁷ P.C.I.J., Ser. A., No. 13 (1928).

¹¹⁸ *Id.* at 51.

with any degree of precision. It is submitted that the concept of "value" is so subjective as to be incapable of precise definition. The *Proposal* avoids this problem by adopting a system of liquidated damages based upon capitalized values.¹¹⁹

In most cases of evaluation arising under an expropriation controversy, the subject matter will be some income-producing operation. Non-income-producing objects which have been obtained as a result of income, such as cash, are more likely to have a relatively fixed value, and, therefore, are not likely to be the subject of an evaluation dispute. An income-producing operation, normally a business firm, is capable of carrying a range of values,¹²⁰ and therefore to define value as being "true value" is to overlook the entire problem.

Value does not exist in the abstract, but must be spoken of in relation to a particular person. In an expropriation controversy, value should be considered as value to the former owner. This is simply another way of saying that in computing compensation, the owner is being compensated for the loss of value to him. It is immaterial what the new owner has gained.¹²¹ The value of the investment, then, is no more than what the owner considers it to be worth to himself.

It is a short step to what is normally considered to be "market value." For, if the value sought is the value that the owner himself places on the investment, this value must be equated to what the investment is worth on the market. The concept of market value is used to eliminate any personal overvaluations on the part of the former owner,¹²² and it places him in the position of the ubiquitous "reasonable man." Market value is therefore usually defined as the price at which a willing seller would transfer his property to a willing buyer given ample time for negotiation.¹²³

Markets are considered by economists to exist whenever property is exchanged. A perfect market would be one in which all sellers could present all goods to all buyers and receive exactly what the buyers

¹¹⁹ *Proposal* art. III, para. C, § 2.

¹²⁰ *Southwestern Bell Tel. Co. v. Public Serv. Comm'n*, 262 U.S. 276, 310 (1922) (Brandeis, J. concurring; Holmes, J. concurring with Brandeis, J.).

¹²¹ *Kimball Laundry Co. v. United States*, 338 U.S. 1, 5 (1948).

¹²² When discussing market value, one should take particular account of the power of a state to regulate the use of property in this type of case. A good example is given by *RESTATEMENT* § 188, ill. 2, in which a state nationalized an electric power utility which was earning 25% on its investment, but compensated the former owner on the basis of 10% returns since this was an average rate of return for investments of this type. This is a justifiable devaluation of the worth of the investment.

¹²³ The standard example is the stock exchange where securities bearing no inherent value are sold by willing sellers to willing buyers both of whom have taken as much time as desired for negotiation.

have paid for the property exchanged. Naturally, no absolutely perfect market exists, although the commercial exchanges come close to the ideal. Suppose we have sellers willing to sell and buyers willing to buy, but *no* buyers willing to buy at a price to which the sellers will agree. Economists would still say that a market exists, albeit an imperfect one. This is at the opposite end of the scale from the perfect market, and unfortunately, is frequently part of the background situation in expropriation cases. Prior to seizure, how much of a market existed for the Suez Canal, the oil industry in Iran, or the sugar plantations in Cuba? Little, if any at all. Market value may be an appropriate concept when determining the value of urban real estate, but it is often most inappropriate in determining the value of an industrial operation in an underdeveloped country.

Two concepts which are used when market value is unascertainable are original cost and replacement cost. Original cost has the advantage of being fairly objective, but frequently bears no relationship to value at a time subsequent to the creation of the investment. Replacement cost may be more current, but frequently bears little necessary relation to value. Consider the proverbial widget factory. It may cost \$1,000,000 to replace a factory which cost \$750,000 to erect. Obviously, neither original cost nor replacement cost is a good measure of value if the factory can produce only \$100 worth of widgets per year. Furthermore, original cost and replacement cost are concerned only with physical assets. Neither can be applied to intangibles such as technology, managerial skills, know-how, trademarks, patents, etc. Furthermore, they are incapable of assessing losses in cases of "creeping expropriation" where it is the earning power of a firm that is expropriated rather than title to its assets.

As has been recognized, the only comprehensive measurement of value of commercial property is the expectation of income from it.¹²⁴ In financial terms, this is the capitalization of earnings of the firm.¹²⁵ Capitalization of earnings is equal to the sum of all anticipated net cash flows which have been discounted by the opportunity cost of capital.¹²⁶ Unfortunately, valuations based upon capitalized values are rarely admitted into evidence. Two objections to such admission have been made: (1) they apply to a whole business and not just to its physical assets, and (2) the formula is subject to a wide margin of error

¹²⁴ Consolidated Rock Prods. Co. v. DuBois, 312 U.S. 510, 526 (1940).

¹²⁵ 1 DEWING, FINANCIAL POLICY OF CORPORATIONS 296-300 (1953).

¹²⁶ See generally ROBICHEK & MEYERS, OPTIMAL FINANCING DECISIONS ch. 2 (1965).

which is most difficult to discredit upon cross-examination.¹²⁷ The first criticism is, in fact, a strong reason for the adoption of this measure in expropriation cases because a taking almost always includes the entire income producing operation rather than solely the physical assets of the investment. A taking is not likely, for example, to be merely a taking of the land on which the factory stands for some other purpose, such as a right-of-way, with the owner using the money received to reestablish his operation elsewhere. Expropriation implies a taking of the entire operation as a going concern (plant, land, trademarks, contract rights, personnel, etc.) for subsequent operation by the state. Similarly, "creeping expropriation" is directed at income-producing ability, rather than at the physical property of the investment.

The second criticism is valid in that the prediction of net income flows well into the future and the opportunity cost of capital (which is a function of both market price and commercial risk) are most difficult to compute. If these were to be agreed upon beforehand, however, and incorporated into a system of liquidated damages, the criticism of their vulnerability upon cross-examination disappears. In negotiations between the prospective investor and the host country, pressures are brought to bear on both parties to agree to requisite contractual terms, and it seems likely that some compromise valuation could be made at this time. (The problem would be entirely different, of course, after an expropriation where the positions of both parties would tend to polarize with a view toward letting the tribunal settle the controversy.) What is even more important here is that most businessmen evaluate possible investment opportunities in some form of present value analysis. They typically compare the present value of income to the present value of expenditures, and if the ratio is favorable, consider the investment worthwhile. Since most large corporations that are engaged in foreign investment evaluate opportunities by this method, the requisite data should be readily available.¹²⁸ Since capitalized values are indeed the most accurate measure of the worth of an enterprise to its owners, and since there is every reason to believe they can be agreed upon beforehand, it is suggested that the "adequacy" of compensation be defined in these terms. This is the approach taken in the *Proposal*.¹²⁹

¹²⁷ 1 BONBRIGHT, VALUATION OF PROPERTY 430 (1937). This two-volume work is the only available comprehensive treatise on value. It is indeed unfortunate that it has not been brought up to date.

¹²⁸ See ISTVAN, CAPITAL-EXPENDITURE DECISIONS: HOW THEY ARE MADE IN LARGE CORPORATIONS (1961), especially ch. 7, "The Measure of Acceptability."

¹²⁹ Proposal art. III, para. C, § 2.

V. THE *Proposal*

The agreement which immediately follows is a model for a bilateral treaty which can be entered into by the United States and any other country in which United States businessmen will be investing. It is bilateral in form simply because it will be far simpler for the United States to negotiate a series of these treaties with various countries than to attempt to secure the simultaneous agreement of several nations in matters on which there is so little accord. Only the essentials are set out in the *Proposal*; the diplomatic language is left to to the draftsman.

THE PROPOSAL

The United States of America and X, desirous of encouraging the flow of private capital from the United States to X, and mindful of the need for reducing the risks to which such capital might be subject while within the territory of X, and in order to make the opportunities existent in X more attractive to the investors of the United States, agree to the rules and principles set forth below:

- I. The United States agrees to use all means at its disposal to encourage its investors to participate in the economic development of X. It specifically agrees:
 - A. To make available technical, financial and legal experts to assist in planning the economic development of X in accordance with the desires of X for its own future;¹³⁰
 - B. To assist prospective investors in the preparation of economic and industrial surveys;
 - C. To make readily available to prospective investors all information pertinent to investment opportunities in X. This shall include, but shall not be limited to, publication of industrial, commercial, and agricultural developments; of applicable laws and legal decisions; and of relevant political announcements;¹³¹
 - D. To provide all personnel, data, and funds necessary to implement the registration system described in article III, paragraph C. *infra*.
- II. A. The United States agrees to recognize and to abide by

¹³⁰ For a discussion of the importance of this aspect of economic development, see PEPELAIS, MEARS & ADELMAN, *ECONOMIC DEVELOPMENT* 132-60 (1961).

¹³¹ The suggestion to set up a similar clearinghouse of information has been made to private United States businessmen. COMMITTEE FOR ECONOMIC DEVELOPMENT, *ECONOMIC DEVELOPMENT ASSISTANCE* 27 (1957).

the right of *X* to develop its own laws and legal principles as it sees fit, with particular regard to the rights which issue from the ownership, procurement, or transfer of private property.

- B. The United States further agrees to insist upon no higher standard of treatment for its citizens, as regards the rights that have been or shall be secured through the ownership, procurement, or transfer of private property, than is afforded by *X* to its own citizens.
- C. *X* likewise agrees to afford citizens of the United States, as regards the rights that have been secured through the ownership, procurement, or transfer of private property, treatment at least equal to that received by its own citizens.

III. A. The United States specifically recognizes that *X* has the right to acquire private property, whether owned by citizens of *X* or of the United States, for any purpose whatsoever.

- B. *X* specifically recognizes that in acquiring private property it has a duty to compensate the former owners for their loss which shall be the value of their property at the time of the acquisition. There shall be no duty to compensate in the following cases, and these cases shall be the only exceptions:

1. A comprehensive acquisition of *all* private property located within the territorial confines of *X* pursuant to a plan of nationalization, providing that no compensation at all is paid.
2. A specific nationalization of *all* private property of a certain type located within the territorial confines of *X*, providing, however, that such acquisition is not discriminatory, either in form or in fact.
3. An acquisition of an investment, or any part thereof, when the investor had reasonable notice before the transfer of any capital to the investment, that such investment would be acquired by *X*. Registration under article III, paragraph C shall be *prima facie* evidence that the investor did not have such notice.

The burden of proof of the existence of an exception is upon the party urging the exception.

C. In order to minimize the disputes that may arise upon an acquisition, *X* and the United States agree to the following scheme of registrations for investments:

1. All prospective investors will submit their investment proposals to a registry of the government of *X* which shall examine such proposals and register those which it deems will further the economic interests of *X*.
2. The certificate of registration shall show, *inter alia*, the expected cash flows of the investment, discounted by the opportunity cost of the capital invested. The opportunity cost shall reflect both the market price of the capital invested and the commercial risk of the investment. Entries shall be made for the first twenty years of the investment, and at the end of each year a new entry shall be made so as to keep the total number of entries at twenty. The value of the investment at any time is hereby agreed to be the sum of all remaining cash flows. Opportunity shall be afforded to renegotiate any or all entries upon determination by either party that such entries do not continue to represent the expected discounted cash flows.

D. Should a total acquisition of the investment by *X* occur, *X* shall immediately be liable to the investor for the total value of the investment as agreed in article III, paragraph B and as defined in article III, paragraph A, section 2. Should a partial acquisition occur, *X* shall immediately be liable for the proportional part of the investment acquired. The burden of proof of the extent of the proportional taking is upon the party urging a proportional rather than a total taking.

E. Compensation shall be paid within six months from the date of the taking in United States dollars unless other arrangements shall be agreed to by both *X* and the investor.

- IV. A. Should a dispute between an investor registered under the provisions of this agreement and X arise as to an obligation flowing from this agreement, or from a registration issued under it, such dispute shall be submitted to the International Centre for Settlement of Investment Disputes authorized under the auspices of the International Bank for Reconstruction and Development by the *Convention on the Settlement of Investment Disputes between States and Nationals of other States*.
- B. The provisions of the present treaty, when ratified, shall be considered to constitute the consent in writing by X and the investors of the United States registered in accordance with its provisions to submit their disputes to the Centre as required by article 25(1) of the *Convention*. The provisions shall also constitute agreement to the rules of law specified in article 42(1) of said *Convention*.
- C. Both X and the United States, sponsor of this agreement for its investors, furthermore specifically agree that access to the courts of either country in order to settle judicially a dispute so arising shall *not* be afforded to either party and that the Centre shall be the only body authorized to settle such disputes.
- D. X hereby specifically waives any claim to the defense of sovereign immunity as to either the jurisdiction of the Centre or the enforcement of its awards.
- V. The following definitions of terms used in this agreement are hereby adopted for use herein:
- A. Investor — any person or juridical person who shall arrange for the placement of capital into an investment located within the territorial confines of X with the purpose of deriving an income from such investment.
- B. Investment—any property located within the territorial confines of X utilized according to a predetermined plan devised by the investor for the purpose of earning an income.
- C. Capital—any property of the investor which shall have been transferred to the investment.
- D. Property—tangible possessions, and intangibles which shall include, but which shall not be limited to, manage-

rial skills, technical know-how, contractual arrangements, patents, secret processes, trademarks, and copyrights; or rights and interests owned in, or obligations due under the above described possessions.

- E. Value, as used in this agreement, shall always be defined as in article III, paragraph A, section 2.
- F. To acquire—to take possession of any of the property of an investment, or to interfere unreasonably with the use, enjoyment, or transfer of such property. An unreasonable interference shall include, but shall not be limited to, imposition of exorbitant taxes, denial of access to requisite industrial inputs or to commercial markets, unwarranted interferences with the management or labor force of the investment, or with their pay scales, or blockage of funds belonging to the investor, the investment or any associated personnel.
- G. Cash flows and opportunity cost shall be the commonly understood terms of the present value formula

$$PV = \sum_{t=1}^{20} \frac{F_t}{(1+r)^t}$$

F_t = net cash flows to investment

r = opportunity cost of capital

t = period (year)

An explanation of the present value formula may be in order.¹³² If a principal P is invested at a rate i for n years, the amount A which the principal will be worth after n years is found by the compound interest formula $A = P(1+i)^n$. The amount A is the answer to the question, "How much will $\$P$ be worth after n years if it is invested at rate i ?" Now ask, "How much will have to be invested at rate i to be worth amount A at the end of n years?" The answer to this is, of course, principal P . Present values are, in essence, the answer to the same question. To put the question in a form more applicable to the concept of present value, one should ask "What is an amount A which is to be invested for n years at a rate i worth today?" The answer is P or, here, the present value of PV of A .

To return to the compound interest formula, $A = P(1+i)^n$, it can

¹³² See generally, ALCHIAN & ALLEN, UNIVERSITY ECONOMICS ch. 15 (1964).

be seen that this is the amount that a *single* principal will be worth after n years. If a new, identical, principal were to be added each year, a new amount A would have to be computed for each new principal. Thus, the formulae would appear as: $[A_1 = P(1+i)^n] + [A_2 = P(1+i)^{n-1}] + [A_3 = P(1+i)^{n-2}] + \dots + [A_n = P(1+i)^{n-n+1}]$ since each succeeding principal is invested for one less year. In mathematical notation, this would be written as

$$\sum_{n=1}^n P(1+i)^n$$

where the Greek letter Sigma simply means to sum all the terms of the expression $P(1+i)^n$ as the value of n ranges from 1 to n . (In computing this sum, the terms would appear in *reverse* order from what was just shown, *i.e.*, as $(P(1+i) + P(1+i)^2 + P(1+i)^3 + \dots + P(1+i)^n)$, but this reversal of sequence will, of course, not change the value of their sum.)

Solving the compound interest formula for P , we have $P = A/(1+i)^n$, or, in present value terms, $PV = A/(1+i)^n$. If all we were looking for is the present value of a single amount A , this formula would suffice. But the firm is expected to have separate cash flows accruing each successive year. A summing-up process similar to that described for compound interest must now be applied. The formula for a sum of present values is, therefore:

$$\sum_{n=1}^n \frac{A}{(1+i)^n}$$

This formula is very close to the one included in the *Proposal*. The variation in cash flow to the firm accounts for the differences. The amount A is, in reality, the net cash flows, F , that the firm expects to receive each year. Since they will probably not be identical, the formula allows them to fluctuate by providing for a different net flow F_t each year. (t , or "time," is identical in function to n which is a more general term.)

If we were computing present values in a no-risk situation (which, of course, never exists) the formula would be complete as it stands. In fact, it is quite acceptable when dealing with minimum risk securities, such as government bonds. In an investment in an underdeveloped

country, however, the element of risk is very significant. The interest rate, or discount rate, as it is called when dealing with present values, must reflect the existing risk. The risk here is not simply the risk of expropriation with which we have been dealing throughout this note but commercial risk in its general sense. This risk is reflected in the formula by adding an arbitrary amount to the market cost of capital i , so that the discount rate now equals the opportunity cost of capital r .¹³³

The formula in the *Proposal*, also does not allow the summation to continue *ad infinitum*. The reason for this limitation is that the values for each term rapidly fall off after a relatively small number of terms. This will be demonstrated (see Table 1) by computing the values of the expression, $F_t/(1 + r)^t$ where F_t is constant (although it need not be) and equal to \$100, and $r = 15$ per cent. $1 + r$, therefore, equals 1.15.

Table 1 shows the present values of \$100 at the end of each year from year 1 to 20 assuming the opportunity cost of capital to be

Table 1

t	1.15 ^t	100 / 1.15 ^t
1	1.15	\$ 87.00
2	1.32	75.80
3	1.52	65.80
4	1.75	57.20
5	2.00	50.00
6	2.32	43.20
7	2.66	37.60
8	3.06	32.70
9	3.53	28.30
10	4.05	24.80
11	4.65	21.50
12	5.35	18.80
13	6.16	16.20
14	7.10	14.00
15	8.17	12.20
16	9.39	10.60
17	10.38	9.70
18	11.95	8.40
19	13.95	7.30
20	15.79	6.30

¹³³ The understandable inability of financial management specialists to provide accurate value of this term is, of course, one reason why this formula bears certain inherent inaccuracies. There is no reason, however, why the differences in opinion between the state and the investor as to the value of the opportunity cost of capital could not be *bargained-out*. For current studies on the cost of capital, see generally SOLOMON, *THE MANAGEMENT OF CORPORATE CAPITAL* (1959); SOLOMON, *THEORY OF FINANCIAL MANAGEMENT* (1963).

15 per cent. The present value of \$100 to be paid at the end of 1 year is \$87.00, at the end of 10 years is \$24.80, etc. The present value of two payments of \$100, one to be made at the end of 1 year and another at the end of 10 years is \$87.00 + \$24.80 or \$111.80. The present value, then, of twenty consecutive annual payments of \$100 each when the opportunity cost of the capital is 15 per cent is the sum of all entries in the right hand column, or \$627.40. The important point to note is that if t were allowed to range from one to infinity, the sum of all the values of $\$100/1.15^t$ would be less than \$670! The reason for arbitrarily limiting the number of terms to be bargained for to twenty should be now obvious. The real significance of this discussion is that since the value of a firm equals its expected earnings, this value can be very closely approximated by estimating the net cash flows over a relatively short period of time.

VI. The *Proposal* Applied to an Actual Expropriation

In order to illustrate how the *Proposal* would operate in practice, its provisions are applied to a recent expropriation case. The case is set in the Republic of the Philippines which may find itself embroiled in expropriation controversies before long because of several judicial decisions interpreting its Nationalization of Retail Trade Act.¹³⁴ This statute was passed as a result of the aura of nationalism which has dominated the politics of the Philippines since its independence in 1946.¹³⁵ On its face, the act simply made it unlawful for any person who is not a citizen of the Philippines, or any business association whose capital was not wholly owned by citizens of the Philippines, to engage in retail trade.¹³⁶ Retail trade was defined as "any act, occupation or calling of habitually selling direct to the general public merchandise, commodities, or goods for consumption"¹³⁷ with certain presently irrelevant exceptions. Individuals who were engaged in retail trade were allowed to continue in business for life, and business associations were given ten years in which to wind up their operations.¹³⁸

¹³⁴ Republic Act No. 1180.

¹³⁵ Cf. Peck, *Administrative Law and the Public Law Environment in the Philippines*, 40 WASH. L. REV. 403, 429 (1965) for the view that the original purposes of the act were directed at the local Chinese who dominated the retail trade business. But cf. Campbell, *The Philippines, "Sugar, Rice and a Great Deal of Vice"*, The New Republic, March 12, 1966, pp. 21-24.

¹³⁶ Republic Act No. 1180, § 1.

¹³⁷ *Id.* § 4.

¹³⁸ *Id.* § 1.

Central Azucarera Don Pedro is a Spanish corporation which was engaged in the manufacture of sugar and derivative products including molasses, dry yeast, and alcohol. All of its output was sold to industrial customers who further processed the products into poultry feeds, and denatured and rectified alcohol. Don Pedro was considered to be engaged beyond the ten year grace period in the "retail business," which was interpreted to include "not only sales in limited quantities to the ultimate consumer of goods for personal or household [sic] consumption, but also sales by manufacturers or producers of goods for industrial or commercial consumption."¹³⁹ In addition to criminal penalties upon the directors, the corporation faced immediate dissolution of its Philippine operations.

Assume that Spain, and not the United States, was signatory to the *Proposal* with the Philippines, and that the *Proposal* was in effect before passage of the Nationalization of Retail Trade Act. Don Pedro is a registrant under the provisions of the *Proposal* and feels that its Philippine assets have been expropriated. What result?

The first question that must be answered is, "Was there an acquisition of Don Pedro's property?" "Acquisition" is defined,¹⁴⁰ *inter alia*, as an unreasonable interference with the use of one's property. An unreasonable interference includes denial of access to commercial markets. Even though no property was actually taken, an acquisition may have occurred through unreasonable interference with the normal use of the Don Pedro production facilities. If it can be established that the products of Don Pedro had, in fact, been denied access to their markets, an acquisition of Don Pedro's property under the terms of the *Proposal* had occurred.

The next question is, "Did the Philippines incur a duty to compensate Don Pedro for its property?" The Philippines has a duty to compensate the former owners for their losses in all cases except for instances of comprehensive nationalizations, specific, but non-discriminatory, nationalizations of a single industry, and when the former owner had reasonable notice that his property would be acquired.¹⁴¹ No comprehensive nationalization occurred, so that exception is eliminated. The nationalization of the entire retail trade industry was a specific nationalization of property of a certain type, but it did not

¹³⁹ Central Azucarera Don Pedro v. Balmaceda, Civil Case No. 57553, Ct. of First Instance of Manila, Dec. 7, 1965, at 14.

¹⁴⁰ Proposal art. V, para. F.

¹⁴¹ *Id.* art. III, para. B.

include *all* property of that type. The property of the Filipinos was not nationalized. This makes out a *prima facie* case of discrimination, and eliminates this exception. Did Don Pedro have notice of the legislation? Clearly, Don Pedro had no notice so far as any assets transferred to its investment before the passage of the act, unless it can be established that Don Pedro had notice while the act was being discussed in the Philippine Congress. Furthermore, Don Pedro might not have had notice as to any assets transferred to its investment after the passage of the act. The act did not on its face apply to industrial suppliers. This extension was purely a creature of the Philippine courts.¹⁴² Certainly, if the *Proposal's* Registry approved the registration of additional assets, Don Pedro had no notice. So, if Don Pedro had no notice, the duty to compensate remains.

The last question is, "What is the amount of compensation due to Don Pedro?" This would be determined by reference to its registration certificate, and would equal the total value shown or the summation of all twenty entries, if acquisition were determined to have occurred at the date of judgment of the decision. It is interesting to note that if Don Pedro had been clearly engaged in retail trade at the time of passage of the act and voluntarily abandoned its investment at the end of ten years, the Philippine government would be liable only for the sum of the *last* ten entries on the certificate. This would be a relatively small amount and would probably be less than what Don Pedro could have received for its property even in a deflated market.¹⁴³ Since Don Pedro would be required to mitigate damages, and if it did actually receive more in the sale of its assets than the liability of the government, the Philippines would not have to pay Don Pedro anything. Similarly, if the act gave Don Pedro twenty years, rather than ten, to wind up its affairs, the government would incur no liability by definition. These two results occur because Don Pedro would not have lost anything either under the terms of the certificate, or in actuality, since the certificate represents, as closely as can be determined, the future earnings of Don Pedro.

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¹⁴² See Peck, *supra* note 135, at 429.

¹⁴³ As an example, assume that Don Pedro's certificate estimated net cash flows of \$10,000 per year (although the amount need not be constant) and that the opportunity cost equalled 15%. The last ten entries of the certificate would then be the same as the last ten entries of Table I, multiplied by a factor of 10. The total amount due Don Pedro then would be \$12,500 or slightly more than a year's net profits.

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